United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

74-2244

ORIGINAL

United States Court of Appeals

For the Second Circuit

FREDERICK E. TINSLEY and ANSTALT DYNOS,

Plaintiffs-Appellees,

against

MAVALA, INC. and C. BENJAMIN DINERSTEIN, individually and doing business under the name and style of C-B SALES CO. and BENDYNE, LTD.,

Defendants-Appellants.

On Appeal from the United States District Court For the Southern District of New York

APPELLANTS' BRIEF

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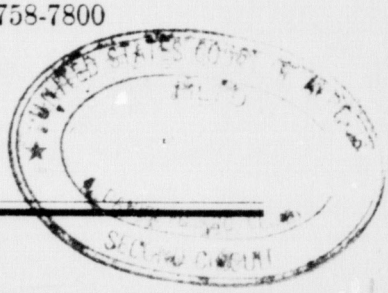

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Statutes Involved

Rule 53. Masters

(a) **Appointment and Compensation.** Each district court with the concurrence of a majority of all the judges thereof may appoint one or more standing masters for its district, and the court in which any action is pending may appoint a special master therein. As used in these rules the word "master" includes a referee, an auditor, an examiner, a commissioner, and an assessor. The compensation to be allowed to a master shall be fixed by the court, and shall be charged upon such of the parties or paid out of any fund or subject matter of the action, which is in the custody and control of the court as the court may direct. The master shall not retain his report as security for his compensation; but when the party ordered to pay the compensation allowed by the court does not pay it after notice and within the time prescribed by the court, the master is entitled to a writ of execution against the delinquent party.

(b) **Reference.** A reference to a master shall be the exception and not the rule. In actions to be tried by a jury, a reference shall be made only when the issues are complicated; in actions to be tried without a jury, save in matters of account and of difficult computation of damages, a reference shall be made only upon a showing that some exceptional condition requires it.

(c) **Powers.** The order of reference to the master may specify or limit his powers and may direct him to report only upon particular issues or to do or perform particular

acts or to receive and report evidence only and may fix the time and place for beginning and closing the hearings and for the filing of the master's report. Subject to the specifications and limitations stated in the order, the master has and shall exercise the power to regulate all proceedings in every hearing before him and to do all acts and take all measures necessary or proper for the efficient performance of his duties under the order. He may require the production before him of evidence upon all matters embraced in the reference, including the production of all books, papers, vouchers, documents, and writings applicable thereto. He may rule upon the admissibility of evidence unless otherwise directed by the order of reference and has the authority to put witnesses on oath and may himself examine them and may call the parties to the action and examine them upon oath. When a party so requests, the master shall make a record of the evidence offered and excluded in the same manner and subject to the same limitations as provided in Rule 43(c) for a court sitting without a jury.

Rule 66. Receivers Appointed by Federal Courts

An action wherein a receiver has been appointed shall not be dismissed except by order of the court. The practice in the administration of estates by receivers or by other similar officers appointed by the court shall be in accordance with the practice heretofore followed in the courts of the United States or as provided in rules promulgated by the district courts. In all other respects the action in which the appointment of a receiver is sought or which is brought by or against a receiver is governed by these rules.

United States Court of Appeals

For the Second Circuit

Docket No. 74-2244

FREDERICK E. TINSLEY and ANSTALT DYNOS,

Plaintiffs-Appellees,

against

MAVALA, INC. and C. BENJAMIN DINERSTEIN, individually and doing business under the name and style of C-B SALES CO. and BENDYNE, LTD.,

Defendants-Appellants.

On Appeal from the United States District Court
For the Southern District of New York

APPELLANTS' BRIEF

Issues Presented for Review

1. Based upon the conflicting affidavits submitted to the Court below, should the Court have denied the application for the appointment of a Receiver?

The Court below answered in the negative.

2. Should the order appealed from be modified to provide for the appointment of Michael Devine, Esq. as Special Master rather than as Receiver of Bendyne?

The Court below, by implication, responded in the negative.

Statement of the Case

Defendants-Appellants, C. Benjamin Dinerstein and Bendyne, Ltd., appeal herein from an order of the United States District Court for the Southern District of New York (Lee P. Gagliardi, J.) entered on August 28, 1974 which granted plaintiffs-appellees' motion for the appointment of a Receiver of Bendyne, Ltd. and designated Michael Devine, Esquire, as said Receiver (A. 225a).

This action was commenced in May of 1963 by Frederick E. Tinsley ("Tinsley") and Anstalt Dynos, S.A. ("Dynos"), a Lichtenstein corporation controlled by Tinsley, against Mavala, Inc. ("Mavala"), a New York corporation, formed in April, 1962, in which Tinsley and Dinerstein were to have equal ownership and control, the individual defendant, C. Benjamin Dinerstein ("Dinerstein") and C-B Sales Co. ("C-B Sales"), a company in which Dinerstein was interested (A. 6a). Mavala was organized to act as the distributor in the United States of products manufactured by Mavala, S.A., a Swiss corporation, in which Tinsley held an interest. Subsequent to the commencement of this action, Dinerstein caused Bendyne, Ltd. ("Bendyne"), a Delaware corporation, to be organized for the sale and distribution of a formaldehyde based nail hardener known as "Living Nail" (A. 7a). Thereafter plaintiffs amended

their complaint to include Bendyne as an additional defendant. In essence, the amended complaint claimed that Dynos was entitled to judgment in the sum of $80,767 from Mavala for goods sold and delivered and that Dinerstein, in violation of his fiduciary duties, appropriated to himself and business entities in which he had an interest, patent rights to a nail protector shield which he had developed in late 1962 and early 1963 with the original intention that such shield might be used in conjunction with the sale of Mavala Scientifique ("Scientifique") (A. 62a).

The amended complaint also claimed that the Bendyne Living Nail product was similar to the formulation of Scientifique and that Bendyne's sale of Living Nail together with an adhesive backed nail protector shield was in violation of the rights of the plaintiffs. The plaintiffs requested a judgment prohibiting the defendants from transferring title or any interest in the patent application for the nail protector shield to any third party or revealing the formulation of "Scientifique" or any trade secrets received by Dinerstein during the course of his relationship with the plaintiffs (A. 62a).

After issue had been joined, plaintiffs moved for a preliminary injunction which was partially granted by Judge Weinfeld which, in pertinent part, enjoined Dinerstein from transferring any rights in the patent application for the nail protector shield; directed Dinerstein and Bendyne to maintain accurate accounts and records of sales of Living Nail; and prohibited Dinerstein from making any disclosure of the formulation of Scientifique as well as transmitting any information regarding trade secrets or sales information (A. 64a).

This action was reached for trial before Hon. Gus J. Solomon, Chief Justice, District Court of Oregon, sitting in the United States District Court for the Southern District by designation. The trial was conducted on October 26, 1970. Thereafter, by opinion dated November 11, 1971, Judge Solomon awarded Dynos judgment against Mavala on its claim for goods sold and delivered in the sum of $80,676 and concluded, among other things, that Dinerstein and Bendyne were required to account to Tinsley for profits earned by Bendyne from the sale of Living Nail on the ground that Dinerstein had violated a fiduciary obligation to Mavala and Tinsley in permitting Bendyne to use such shield in the sale of Living Nail and in refusing to permit Mavala to use the shield in connection with the sale of Scientifique (A. 6a). An interlocutory judgment was entered on January 4, 1972 (A. 14a).

Pursuant thereto Dynos was awarded judgment against Mavala for the invoiced value of goods sold and delivered; the preliminary injunction issued by Judge Weinfeld was made permanent and defendants Bendyne and Dinerstein were ordered to account for the profits earned by Bendyne in connection with the sale of Living Nail. The interlocutory judgment directed the defendants to produce for inspection and copying all records regarding sales of Living Nail and the nail shield protector and income derived from such sales (A. 15a). The judgment further provided that records relating to the sales of Living Nail were to be made available to plaintiffs' representatives and if the parties were unable to agree on the amount due to Mavala, the issue would be referred to a Special Master (A. 15a).

Subsequent to entry of the interlocutory judgment, defendants furnished plaintiffs' counsel with copies of Ben-

dyne's income tax returns but objected to permitting a complete review of all of Bendyne's records in view of the keen competition which has existed since August of 1963 in connection with the competing sales of Scientifique and Living Nail (A. 42a).

Plaintiffs thereafter moved to punish defendants Dinerstein and Bendyne for contempt for failure to supply all of Bendyne's records to plaintiffs' counsel. This motion by plaintiffs was withdrawn in June of 1972 after an agreement had been reached that the records would be masked so as not to disclose the identity of Bendyne's customers and suppliers (A. 43a). After plaintiffs' accountants reviewed the masked records, they concluded that the information, in the form submitted, was insufficient for their purposes.

Thereafter, in response to plaintiffs' suggestion that the records be unmasked and examined pursuant to a stipulation that the material presented would not be disclosed except as the result of a court order and based upon a conference with Judge Gagliardi, Bendyne was directed to unmask the records and make them available to plaintiffs' counsel and accountants (A. 107-08a). The direction by Judge Gagliardi was complied with and after the records had been unmasked they were made available at defendants' counsel's office commencing in early November 1972. During the period November 1972 to February 1973 these records were constantly available for examination by plaintiffs' accountants who, from time to time, consulted with representatives of Ash & Parsont, Bendyne's accountants, for answers to questions (A. 135-36a).

Subsequently, in late March 1973, plaintiffs submitted voluminous interrogatories to defendants which required an analysis of records covering a period of approximately eight years in order to properly respond (A. 88a). While defendants' answers and objections to plaintiffs' interrogatories were being prepared, plaintiffs moved for appointment of a Receiver of Bendyne and an order compelling Dinerstein and Bendyne to answer the written interrogatories. The interrogatories were submitted on August 13, 1973 (A. 140a). Thereafter oral argument took place before Judge Gagliardi and on March 12, 1974 Judge Gagliardi granted the motion without opinion.

On March 13, 1974 an order was entered appointing Hon. Otto C. Jaeger as Receiver of Bendyne (A. 209a). Judge Jaeeger declined to accept the office of Receiver of Bendyne in view of his other commitments and after several communications from plaintiffs' counsel, Judge Gagliardi filed an order on August 28, 1974 withdrawing the March 13, 1974 order and appointing Michael Devine, Esq. as Receiver.

Summary of Argument

POINT I—Based upon the conflicting affidavits submitted to the Court below, the Court should have denied the application for the appointment of a Receiver.

POINT II—In the alternative, the order appealed from should be modified to provide for the appointment of Michael Devine as a Special Master rather than as Receiver of Bendyne.

POINT I

Based upon the conflicting affidavits submitted to the Court below, the Court should have denied the application for the appointment of a Receiver.

The foundation for plaintiffs' motion for the appointment of a Receiver for Bendyne is a series of unsubstantiated allegations of waste and dissipation which purportedly took place between 1964 and 1971 as set forth in affidavits submitted by plaintiffs' counsel. It is apparent that although plaintiffs' counsel and accountants had access to the Bendyne records for many months in 1972 and 1973, they have misinterpreted and misunderstood a substantial amount of the information presented.

For example, plaintiffs' counsel has attempted to intertwine the activities of Bendyne with the firm of Benesco, Inc. (A. 109a) As demonstrated by the opposing affidavit of Dinerstein, Benesco is completely unrelated to Bendyne and was a completely independent advertising agency. In fact, as is pointed out in the Dinerstein affidavit, litigation resulted from a dispute between Bendyne and Benesco. (A. 206a)

Plaintiffs' counsel alleges, without any proof or substance, that the volume of advertising expenditures made by Bendyne in its early years could only have occurred if Bendyne were paying advertising expenditures for affiliated companies and thereby wasting Bendyne assets. (A. 109a) Defendants' answers to the interrogatories clearly spells out each and every advertising expenditure

made solely for the account of Bendyne during the first eight years of Bendyne's existence. (A. 161a-65a) Plaintiffs attempt to create a foundation for the alleged dissipation of Bendyne's assets where certain payments were made from Bendyne for the personal living expenses of Dinerstein. It is conceded that some of such expenses were paid. Plaintiffs, however, ignore the fact that Dinerstein loaned the sum of $26,500 to Bendyne in January 1971 and that any disbursements from Bendyne for Dinerstein's personal expenses have been credited against that loan. (A. 191a) It is significant to note that the alleged improper expenses which plaintiffs claim have been disbursed involve matters occurring between approximately 1964 and 1971, all of which are reflected in the Bendyne records.

Dinerstein has contended that he used his 1962 automobile in connection with the business affairs of Bendyne and that payments from Bendyne for automobile insurance and garage expense during the period that he owned and used the automobile were proper. (A. 207a) Assuming for the sake of plaintiffs' argument that such payments were improper, the difference of opinion on this subject does not justify the drastic remedy of the appointment of a Receiver for Bendyne.

Similarly, plaintiffs' reliance on purportedly improper intercompany transactions with C.B. Sales is a matter which obviously terminated when the assets of that business were sold by a State Court Receiver, appointed in July of 1970, at an auction sale in January of 1971. Clearly, there has been no pattern of intercompany transactions since the liquidation of C.B. Sales in 1971.

Plaintiffs' reliance on allegedly improper intercompany transactions between Bendyne and Bendyne Products Inc. ignores the fact that Bendyne Products has been dormant since 1966. Clearly, none of the plaintiffs' allegations to the Court below presented any current emergency condition or any existing pattern of current depletion of the Bendyne assets.

The appointment of a Receiver has repeatedly been held to be an extraordinary remedy to be resorted to only where injury to property cannot otherwise be avoided. *Chambers* v. *Blickle Ford Sales, Inc.*, 313 F.2d 252 (2d Cir., 1963); *Mintzer* v. *Arthur L. Wright*, 262 F.2d 823 (3rd Cir., 1959).

It is respectfully submitted that based upon the conflicting affidavits presented to the District Court, plaintiffs did not sustain the very heavy burden of proof placed upon a party seeking the appointment of a Receiver. See, *Wickes* v. *Belgian American Educational Foundation, Inc.*, 266 F.Supp. 38 (S.D.N.Y., 1967). In the *Wickes* case, the Court denied plaintiff's motion for an order appointing a Receiver and noted that the resort to the extraordinary remedy of receivership should not be made except in cases of urgent necessity and upon a demonstrated existing emergency. It is submitted that the plaintiffs' contention below did not meet the strict standards established by the *Wickes* case.

The Courts have announced that a receivership is a drastic remedy to be imposed only when no lesser relief will be effective. *Ferguson* v. *Tabah*, 288 F.2d 665 (2d Cir., 1961). A further factor which must be considered

in reviewing the ruling of the District Court is that Bendyne is operating on a profitable basis. Our courts have held that

> "The appointment of a receiver of a going concern is a drastic remedy, and can properly be invoked only where there is a clear evidentiary showing of the necessity for the conservation of property and the protection of the interests of the litigant." *Glassner* v. *Kaufman,* 19 A.D.2d 885 (First Dept., 1963); *S.Z.B. Corp.* v. *Ruth,* 14 A.D. 2d 678 (First Dept., 1961); *Laber* v. *Laber,* 181 App.Div. 733 (Second Dept., 1918).

Defendants contend that the case of *Maxwell* v. *Enterprise Wall Paper Mfg. Co.,* 131 F.2d 400 (3rd Cir., 1942), is closely analogous to the instant case. In *Maxwell,* the Circuit Court reversed a District Court order appointing Receivers for Enterprise Wall Paper Mfg. Co. Plaintiff, a minority shareholder, complained of gross mismanagement and waste by the majority shareholder consisting of the majority shareholder's employment of relatives at exorbitant salaries, payment of salaries to relatives who rendered no services, creation of fictitious expense accounts for non-existent employees to drain funds from the corporation to the majority shareholder and his relatives, appropriation of corporate opportunities for the personal benefit of the majority shareholder, sales of merchandise to corporations controlled by the majority shareholder at prices below cost, fraudulent loan transactions and destruction of business records and accounts.

The Court noted in reversing the District Court that many of the alleged improper diversions of corporate funds occurred from four to six years prior to the appointment

of the Receiver and stated that while plaintiff's allegations might establish past misconduct, plaintiff did not establish the extreme and exceptional circumstances under which a Receiver should be appointed. With regard to the appointment of a Receiver, the Court held

> "It is not to be resorted to if milder measures will give the plaintiff, whether creditor or shareholder, adequate protection for his rights." 131 F.2d at 403.

In reversing the order appointing Receivers, the Court stated:

> "We do not find in the allegations, however, any such grounds of immediate emergency that call for the appointment of a receiver, characterized in the decisions as one of last resort, to the exclusion of other remedies." (Id. at 404).

It is submitted that in applying the principles of the holding in the *Maxwell* case that this Court should reverse the order appealed from.

POINT II

In the alternative, the order appealed from should be modified to provide for the appointment of Michael Devine as a Special Master rather than as Receiver of Bendyne.

The defendants urge that if the Court is not convinced that the order appealed from should be reversed, then, in the alternative, defendants contend that the order should be modified to provide for the appointment of Michael Devine as Special Master rather than as Receiver of Ben-

dyne. In the opinion of Judge Solomon, he held that if the parties could not agree on the amount due to Mavala (or one-half thereof to Tinsley) within thirty days that such issue would be referred to a Special Master (A. 13(a)).

In paragraph 5 of the Interlocutory Judgment, Judge Solomon directed that failing an agreement between the parties on the amount due, "* * * the matter shall be referred to a Special Master." (A. 15(a)).

The parties have clearly been unable to agree on the amount due. The defendants have repeatedly requested that the Court refer the issue to a Special Master (A. 197(a), A. 208(a)).

It is clear that what must be resolved is the amount due to Mavala (or one-half thereof to Tinsley) pursuant to Judge Solomon's decision and Interlocutory Judgment. This can be accomplished by modifying Judge Gagliardi's order and providing for the appointment of Michael Devine as Special Master rather than as Receiver of Bendyne. Pursuant to Rule 53, a Special Master would clearly be authorized to make such a computation after a proper investigation and review of accountants' reports. One of the prime functions of a reference to a Special Master is to resolve complex matters requiring detailed examination of books and records covering a protracted period of time. This procedure has repeatedly been upheld. *Barrick* v. *Pratt,* 32 F.2d 732 (5th Cir., 1929); *Chappel & Co.* v. *Frankel,* 285 F.Supp. 798 (S.D.N.Y., 1968); *Marvel Specialty Co.* v. *Bell Hosiery Mills,* 235 F.Supp. 218 (W.D., No. Car., 1964); *Dorchester Music Corp.* v. *National Broadcasting Co.,* 171 F.Supp. 580 (S.D., Cal., 1959).

If Michael Devine were appointed Special Master with virtually identical responsibilities and duties as those contained in the order appealed from, the desired result could be achieved. Under the circumstances presented, it is submitted that a Receiver is unnecessary and improper. The appointment of the Receiver obviously creates a competitive advantage for permitting the plaintiffs to use such information to improperly compete with Bendyne in the nail hardening field in which the parties have been in intense competition for over eleven years.

Conclusion

The order of the Court below (Gagliardi, J.) appointing Michael Devine as Receiver of Bendyne should be reversed, or, in the alternative, modified by providing that Michael Devine be appointed as Special Master rather than Receiver, and the costs of this appeal should be awarded to the defendants-appellants.

Dated: New York, New York
December 27, 1974

Respectfully submitted,

WEIL, GOTSHAL & MANGES
Attorneys for Defendants-Appellants

MICHAEL K. STANTON
Of Counsel

Service of 2 copies of the
within Brief is hereby
admitted this 30th day of
Dec. 1974
Signed Goldenberg and Barell
Attorney for Plaintiffs-Appellees

Copy Received 12/30/74 3:35 PM
Goldenberg and Barell

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